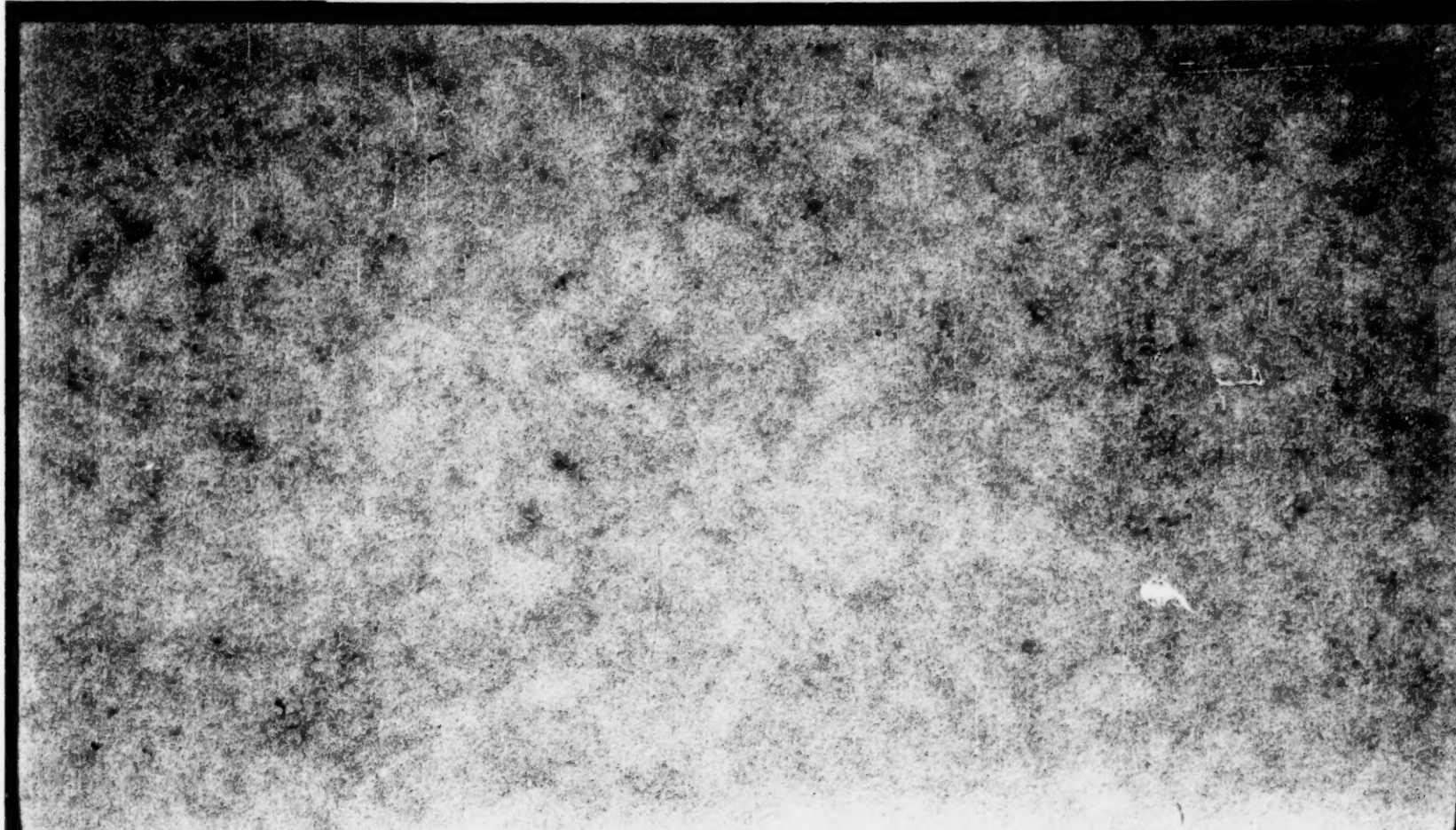


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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

NO. 6

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

vs.

SUSAN DWIGHT BLISS

BRIEF AS AMICUS CURIAE ON BEHALF OF AARON STRAUS

FREDERICK SCHWERTNER,
Counsel for Aaron Straus,
1000 National Press Building,
Washington, D. C.

UNITED PUBLISHING COMPANY INC., 717 SIXTH ST. N. W., WASHINGTON, D. C.

INDEX

PAGE

I. PRELIMINARY STATEMENT 1

II. QUESTIONS INVOLVED 2

III. THE FACTS 3

IV. THE STATUTE 4

V. ARGUMENT 11

A. The Courts Have Consistently Held That the 15 Per Cent Limitation on the Deduction for Charitable Contributions Is To Be Measured By a Taxpayer's Total Net Income, Including Capital Net Gain 11

B. Congress By Adopting Section 23 (n) Plainly Evinced a Legislative Policy To Encourage Charitable Contributions, and This Policy Was Not Reversed In 1921 When the Capital Gain Provisions Were Enacted 15

C. The Term "Net Income," As Used in Section 23 (n) Means the Net Income As Defined By Sections 21, 22 and 23 and Includes A Capital Net Gain 21

D. It Was the Administrative Practice of the Commissioner from 1921 To 1932 To Allow As A Deduction Charitable Contributions Up To 15 Per Cent of a Taxpayer's Total Net Income, Including Capital Net Gain 23

E. The Capital Gain Provisions Do Not Serve To Impair or Destroy the Deduction for Charitable Contributions 35

F. If the Statute Is At All Ambiguous and A Doubt Exists, Such Doubt Is To Be Resolved Against the Government 45

VI. CONCLUSION 46

CITATIONS

CASES

PAGE

American Can Co. v. Bowers, 35 F. (2d) 832 23
Andrus et al. v. Burnet, 50 F. (2d) 332 46
Benziger v. U. S., 193 U. S. 38 46
Bliss, Susan Dwight, 27 B. T. A. 205 ..... 12, 25
Bliss v. Commissioner, 68 F. (2d) 890 12
Blow et al. v. U. S., 5 F. Supp. 737 12
Brewster v. Gage, 280 U. S. 327 28
Burnet v. Harmel, 287 U. S. 103 18
Church of Holy Trinity v. U. S., 143 U. S. 457 31
Colgate, Mary, 27 B. T. A. 506 ..... 12, 25
Copper Queen Mining Co. v. Arizona Board, 206 U. S. 474 29
Eisner v. Macomber, 252 U. S. 189 23
Elkins, Hallie D., 24 B. T. A. 572 ..... 24, 29
Fisher, Irving, 30 B. T. A.— 12
Gould v. Gould, 245 U. S. 151 45
Harbison, Ralph W., 26 B. T. A. 896 ..... 12, 25
Helvering v. Straus, 27 B. T. A. 1116 ..... 1, 4, 11, 33, 38
Helvering v. New York Trust Co., 78 L. ed. 960 19
Igleheart v. Commissioner, 27 B. T. A. 1426 12
Komada & Co. v. U. S., 215 U. S. 392 28
Latimer v. U. S., 223 U. S. 501 28
Lau Ow Bew v. U. S., 144 U. S. 47 31
Lederer v. Stockton, 260 U. S. 3 46
McCaughn v. Hershey Chocolate Co., 283 U. S. 488 28
McDonald v. Hovey, 110 U. S. 619 29

Merchants' Loan & Trust Co., Tr. v. Smietanka, 225 U. S. 509 23
National Lead Co. v. U. S., 252 U. S. 140 28
N. Y., N. H. & H. R. R. Co. v. I. C. C., 200 U. S. 361 29
Old Colony R. R. Co. v. Commissioner, 284 U. S. 552 46
Poe v. Seaborn, 282 U. S. 101 28
Reese, Augusta Bliss, 30 B. T. A.— 12
Robertson v. Downing, 127 U. S. 613 29
Robinette v. Commissioner, 27 B. T. A. 1426 12
Sadowsky v. Anderson, 29 F. (2d) 677 ..... 12, 14
Stonega Coke & Coal Co. v. Commissioner, 57 F. (2d) 1030 31
Universal Battery Co. v. U. S., 281 U. S. 580 28
U. S. v. Baruch, 223 U. S. 191 28
U. S. v. Cerecedo Hermanos y Compania, 209 U. S. 337 28
U. S. v. Dakota-Montana Oil Co., 288 U. S. 459 28
U. S. v. Falk and Bro., 204 U. S. 143 29
U. S. v. Katz, 271 U. S. 354 31
U. S. v. Kirby, 74 U. S. 482 31
U. S. v. Philbrick, 120 U. S. 52 29
U. S. v. Provident Trust Company, 78 L. ed. 510 16
U. S. v. Updike, 281 U. S. 489 45
White, Collector v. Atkins, 69 F. (2d) 960 12
Woodward v. Commissioner, 27 B. T. A. 1426 12

MISCELLANEOUS

Federal Tax Handbook (1932) by Robert H. Montgomery, pages 475-476 33
Mimeograph 3931, Cumulative Bulletin XI-1, p. 33, Bureau of Internal Revenue 24
Prentice-Hall Tax Service (1932), p. 14905 25
Report No. 179, 68th Cong., 1st Sess., Committee on Ways and Means 39

Report No. 275, 67th Cong., 1st Sess., Senate Finance Committee 19
Report No. 398, 68th Cong., 1st Sess., Senate Finance Committee 20
Treasury Regulations 62, Articles 21, 251 ..... 23, 26
Treasury Regulations 65, Articles 21, 251 ..... 23, 27
Treasury Regulations 69, Article 21, 251 ..... 23, 27
Treasury Regulations 74, Articles 41, 261 ..... 22, 27
Treasury Regulations 77, Article 261 27

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BRIEF AS AMICUS CURIAE ON BEHALF OF AARON STRAUS

I.

Preliminary Statement

Aaron Straus is the appellee in the case of *Guy T. Helvering, Commissioner of Internal Revenue, Appellant v. Aaron Straus*, 27 B.T.A. 1116, which is pending after argument before the Court of Appeals of the District of Columbia on the appellant's petition for review.

The issue in the *Straus* case is similar to that in the *Bliss* case and involves a construction of Section 23 (n) of the Revenue Act of 1928, which provides that in

computing net income contributions to charitable institutions shall be allowed as deductions from gross income to an amount which does not exceed 15 per centum of the taxpayer's "net income," as computed before any allowance for contributions.

Aaron Straus in the year 1929 had a total net income of $809,543.86, consisting of "ordinary net income," of $43,079.90, before any allowance for contributions, and a "capital gain" of $766,463.96, before any allowance for contributions. There were no items of capital loss or capital deductions for the year 1929.

Aaron Straus donated to charitable institutions in the year 1929 the sum of $144,695.04. The Commissioner of Internal Revenue only allowed as a deduction for such contributions the sum of $6,461.99, under his theory which was first adopted in the year 1932 that when a taxpayer has a "capital net gain," and elects to be taxed thereon at 12½ per cent, the deduction for charitable contributions is confined to 15 per cent of his "ordinary net income."

In a unanimous opinion by the full Board, it was held that Aaron Straus was entitled to a deduction of $121,431.78 for charitable contributions, such sum being 15 per cent of his total net income, before any allowance for contributions.

II.

Questions Involved

The questions involved are simple: What is the meaning of the term "net income," as used in Section

23 (n) of the Revenue Act of 1928? Does the net income from the sale of investment property held more than two years, denominated a "capital net gain," by Section 101 (c) (5) of the 1928 Act, form a part of "net income," as that term is used in Section 23 (n)? Did Congress by the adoption of the capital gain provisions intend to invade Section 23 (n) with the result that a taxpayer's deduction for charitable contributions is either impaired or wholly destroyed?

It was the uniform administrative practice of the Commissioner of Internal Revenue to allow charitable contributions as deductions to the limit of 15 per cent of a taxpayer's total net income, including capital net gain, from 1921, when the capital gain provisions were originally adopted, to 1932, when he reversed his position.

III.

The Facts

The *Bliss* case involves the years 1928 and 1929, and the issue as to the amount allowable as a deduction for charitable contributions is common to both taxable years. It will suffice, therefore, to state the facts with reference to the year 1928 only. During that year, the taxpayer made charitable contributions in the amount of $43,995.92. Her "ordinary net income," for the year 1928 before the deduction of the amount of such contributions was $270,490.77, and her "capital net gain" was $211,544.82. The Commissioner of Internal Revenue allowed as a deduction for charitable contributions the sum of $40,573.62, being 15 per cent of her "ordinary net income," as computed before the

deduction for charitable contributions, and disallowed as a deduction the balance of $3,422.30.

The destructive effect of the Commissioner's construction of the term "net income," as used in Section 23 (n) of the 1928 Act to mean "ordinary net income," when a "capital net gain" is present is more glaringly patent in the *Straus* case. In the *Straus* case, the taxpayer is entitled to a deduction for charitable contributions in the sum of $121,431.78 if his total net income is used as a measuring rod. The Commissioner, however, only allowed the sum of $6,461.99, which is less than 1 per cent of the taxpayer's total net income, and disallowed as a deduction the balance of $114,969.79.

IV.

The Statute

The pertinent portions of the Revenue Act of 1928 are as follows:

TITLE I—INCOME TAX

Sec. 23. Deductions from Gross Income

In computing net income there shall be allowed as deductions:

Section 23 (n) Charitable and Other contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by Section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts, or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules

and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see Section 120.) (Italics supplied.)

PART II—COMPUTATION OF NET INCOME

Sec. 21. Net Income

"Net income" means the gross income computed under Section 22, less the deductions allowed by Section 23.

Sec. 22. Gross Income

(a) General definition. "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, *or sales, or dealings in property,* whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. (Italics supplied.) * * *

(e) Determination of Gain or Loss. In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in Sections 111, 112, and 113.

Sec. 23. Deductions from Gross Income

In computing net income there shall be allowed as deductions:

(a) Expenses. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

(b) Interest. All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

(c) Taxes Generally. Taxes paid or accrued within the taxable year, except—

(1) Income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) so much of the income, war-profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under section 131; and

(3) taxes assessed against local benefits of a kind tending to increase the value of the prop-

erty assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

For the purpose of this subsection, estate, inheritance, legacy, and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes, and shall be allowed as a deduction only to the estate. * * *

(d) Taxes of Shareholders Paid by Corporation. * * *

(e) Losses by Individuals. In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

(f) Losses by corporations. * * *; (g) Basis for determining loss * * *; (h) Loss on sale of stock or securities * * *; (i) Net Losses * * *; (j) Bad debts * * *; (k) Depreciation * * *; (1) Depletion * * *; (m) Basis for depreciation and depletion * * *; (n) Charitable and other

contributions * * *; (o) Future expenses in case of casual sales of real property * * *; (p) Dividends received by corporations * * *; (q) Pension trusts * * * .

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement A—Rates of Tax

(Supplementary to Subtitle B, Part I)

Sec. 101. Capital Net Gains and Losses

(a) Tax in Case of Capital Net Gain. In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) Tax in Case of Capital Net Loss. In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows; a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax

shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) Definitions. For the purpose of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchange during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by Section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition— * * *

(d) Collection and Payment of Tax. The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

V.

ARGUMENT

A

THE COURTS HAVE CONSISTENTLY HELD THAT THE 15 PER CENT LIMITATION ON THE DEDUCTION FOR CHARITABLE CONTRIBUTIONS IS TO BE MEASURED BY A TAXPAYER'S TOTAL NET INCOME, INCLUDING CAPITAL NET GAIN.

The unanimous opinion of the full Board in the *Straus* case served to repudiate and overrule the deci-

sions of individual members in *Ralph W. Harbison*, 26 B.T.A. 896, *Susan Dwight Bliss*, 27 B.T.A. 205 and *Mary Colgate*, 27 B.T.A. 506. The views expressed by the full Board in the *Straus* case have been adopted by the Courts in an unbroken line of decisions.

Bliss v. *Commissioner of Internal Revenue*, (C.C.A. 2), Jan. 8, 1934, 68 F. (2d) 890;
White, Collector of Internal Revenue v. *Atkins*, (C.C.A. 1), Mar. 14, 1934, 69 F. (2d) 960;
Blow et al. v *U. S.* (N.D. Ill.) Sept. 21, 1933, 5 F. Supp. 737.

The Board has also followed its decision in the *Straus* case in *Robinette* v. *Commissioner*, 27 B.T.A. 1426, *Igleheart* v. *Commissioner*, 27 B.T.A. 1426, *Woodward* v. *Commissioner*, 27 B.T.A. 1426, decided by unpublished memoranda opinions, *Augusta Bliss Reese*, decided March 6, 1934, 30 B.T.A. —, and *Irving Fisher*, decided April 20, 1934, 30 B.T.A. —.

There is no federal court decision in any jurisdiction which supports the respondent in his contention that capital gain should be excluded from net income in determining the 15% deduction for charitable contributions.

Although necessarily classed as *obiter dicta*, it was definitely recognized by the Circuit Court of Appeals for the Second Circuit in *Sadowsky* v. *Anderson*, 29 F. (2d) 677, decided December 10, 1928, affirming 25 F. (2d) 1014, certiorari denied 49 S. Ct. 346, 279 U. S. 849, 73 L. Ed. 992 that the 15% deduction for charitable contributions was not affected by the capital gain provisions of the Revenue Act of 1921 (substan-

tially reenacted in the Revenue Act of 1928). In that case the taxpayer was the owner of a clothing business which he incorporated on June 6, 1919. He had other sources of income. With respect to the income of the business, he chose to be taxed for the year 1918 and that portion of the year 1919 prior to incorporation as if the income were that of a corporation. This was permitted by Section 330 of the Revenue Act of 1918. The question was whether the deduction for charitable contributions was limited in amount of 15% of his net income, *including* or *excluding* that part of his income which was computed and taxed as corporate income pursuant to Section 330. The Commissioner of Internal Revenue refused to allow any deduction for charitable contributions based on business income, because no such deduction was allowed corporations in computing their net income under the Revenue Act of 1918.

The Court decided in the Commissioner's favor, denying the deduction on business income which was computed and taxed as that of a corporation, but the following language in the opinion of Judge Augustus N. Hand indicates the distinction which, applied to the *Bliss* case, would result in granting the deduction based upon net income inclusive of capital gain (p. 678):

> "The fact that the allowance of charitable gifts was not cut off where income of individuals derived from capital gains was taxed at special rates under Section 206 of the Revenue Act of 1921 (42 Stat. 232), and that it was similarly available where dividends of prior years were received in 1917, or subsequent years, but taxed at prior years' rates cannot extend the deduction

> to income derived from plaintiff's clothing business. The option in those cases related merely to rates, and was accompanied by no language providing for the 'computation' of the income as that of a corporation."

In view of the fact that the Government is now on the other side of the fence and is contending that the capital gain provisions *do* cut down on the charitable contributions, it is interesting to note the following excerpt beginning on page 9 of the Government's brief in the *Sadowsky* case:

> "4. That the plaintiff loses sight of the fact that the income which is taxed at corporate rates is not the income of the individual strictly, but the income of trade or business treated as a corporation, is apparent by the supposed analogies which he offers in support of his conclusion. Both instances cited by him (*capital gain provisions and prior year dividends received in 1917) were cases of options to the taxpayer as to what rate was to be paid upon part of his income. They did not, as here, affect the method of computing net income, nor did they deal with splitting an individual into two distinct legal personalties. In each instance, the net income was computed in accordance with the provisions of the statute dealing with an individual. It lay with the taxpayer to decide whether as to part of his income one rate or the other would apply, but the whole income was measured and determined by the provisions relating to individuals. Here the net income from the business is as separate and distinct from the net income from other sources of the individual to the same extent as though the business had in fact been incorporated and the plaintiff were its

*MY INSERTION.

sole strockholder. *In the two instances cited, therefore, there was every reason why the taxpayer should be allowed a deduction up to 15% of his income on account of his charitable contributions, for the option there was an option merely as to rates, not as to the determination of the amount of net income.*" (Italics supplied.)

B

CONGRESS BY ADOPTING SECTION 23 (n) PLAINLY EVINCED A LEGISLATIVE POLICY TO ENCOURAGE CHARITABLE CONTRIBUTIONS, AND THIS POLICY WAS NOT REVERSED IN 1921 WHEN THE CAPITAL GAIN PROVISIONS WERE ENACTED.

The provision permitting a deduction from gross income of charitable contributions to the extent of 15 per cent of the net income computed without the benefit of this deduction was originally introduced by the Revenue Act of 1917 upon the advent of high taxes in this country. Section 1201 (2) of the Revenue Act of 1917, amending the Act of 1916, provided that charitable contributions may be deducted "to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph." Its obvious purpose was to encourage gifts for charity, education and science. Congressional Record, September 7, 1917, p. 6728. It has been continued in substantially the same form in each successive revenue act, the Revenue Acts of 1918, 1921, 1924, 1926, 1928, 1932 and 1934.

In furtherance of the policy to encourage charitable gifts, Congress also provided that for Federal estate tax purposes the amount of all bequests to charitable institutions shall be deducted from the value of the

gross estate. The purpose of the enactment of this particular legislation was well recognized in *U. S.* v *Provident Trust Company*, 78 L.ed. 510, 514, decided February 5, 1934, wherein this Court, speaking through Mr. Justice Sutherland, made the following pertinent observation:

> "We have for consideration simply a statutory provision exempting from a prescribed tax the value of all bequests, etc., made to or for the use of charitable organizations and those which are akin, plainly evincing a legislative policy to encourage such bequests. Edwards v. Slocum, 264 U. S. 61, 63, 68 L. ed. 564, 565, 44 S.Ct. 293. And, in that view, we may well assume that Congress could not have meant to leave its aim to be diverted by a purely arbitrary presumption, which whether applicable or not to sustain another or different policy, would deny the truth and subvert the policy of this particular legislation. Compare Humes v. United States, supra (276 U. S. at p. 494, 72 L. ed. 670, 48 S.Ct. 347)."

When the capital gain provisions were adopted in 1921, it clearly was not within the mind of Congress that the same would clash with the provisions permitting a deduction for charitable contributions to the extent of 15 per cent of a taxpayer's net income. It was not the aim of Congress by the adoption of the capital gain provisions to in any manner impair or wholly destroy the deduction for charitable contributions. The amount allowable as a deduction for charitable contributions is governed by Section 23 (n), and not by Section 101 which contains the capital gain provisions. When the Commissioner seeks to read into Section 23 (n) a further limitation so as to confine the deduction to 15 per cent of a taxpayer's ordi-

nary net income where part of his net income consists of a capital net gain, he clearly is usurping a legislative function beyond his power. Such a position tends to thwart or defeat the policy of Congress to encourage charitable contributions, and produces incongruous results inconsistent with the legislative purpose.

To illustrate the inequitable operation of the statute under the Government's present view, assume three taxpayers made charitable contributions of $30,000 each and had respective incomes as follows:

	A	B	C
Gain (or loss) from business.....	($100,000)	$100,000	$200,000
Gain from sale of capital assets...	300,000	100,000	None
Net income (before a deduction for contributions)	$200,000	$200,000	$200,000

In accordance with the provisions of Section 23 (n) and the statutory definition of "net income," which is conclusive, there is an allowable deduction for contributions, within the limitation, of $30,000 in each of the above cases. However, following the Government's theory, the deduction is determined not by the question of the *amount* of net income, exclusive of a deduction for contributions, but by the kind of net income realized. Under that view, A would be allowed a deduction for contributions of zero, B a deduction of $15,000 and C a deduction of $30,000, despite the fact that each has the same statutory net income.

It is not to be presumed, without clear legislative pronouncement to the contrary, that taxpayers having the same economic and statutory net income are to be treated so differently.

Congress in enacting the capital gain provisions in 1921 sought to stimulate the conversion of capital investments, and to remove the deterrent effect of high surtax rates on such transactions. Under the Revenue Act of 1921, the surtax rates ranged from 1% to 65% on incomes in excess of $5,000.00. Congress was undoubtedly convinced that the high rates of tax retarded sales of investment property with a consequent loss of revenue to the Government. In remedying this situation by the adoption of the capital gain provisions, Congress envinced no purpose to subvert its policy to encourage contributions to charitable organizations. The two policies are entirely unrelated, and both of them may be effectually accomplished by a reasonable and sensible construction of the statue.

The legislative purpose of the enactment of the capital gain provisions was well stated by Mr. Justice Stone, who delivered the opinion of the Supreme Court of the United States in *Burnet* v. *Harmel*, decided November 7, 1932, 287 U. S. 103,106, as follows:

> "Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such

> conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess. on the Revenue Bill of 1921, p. 10; see Alexander v. King (C. C. A. 10th) 74 A. L. R. 174, 46 F. (2d) 235."

The legislative reasons for the adoption of the capital gain provisions were also adverted to by Mr. Justice Butler in *Helvering* v. *New York Trust Co.*, 78 L. ed. 960, 964, 54 S. Ct. 806, 809, decided May 28, 1934.

In Report No. 275, 67th Cong., 1st Sess., Senate Finance Committee, covering the Revenue Bill of 1921, which for the first time introduced the capital gain provisions, it is stated on the subject of deductions:

> "Section 214 allows substantially the same deductions in computing net income as are allowed under existing law * * *."

The Revenue Act of 1918 authorized a deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income.

In the absence of any expression of legislative intent to employ the capital gain provisions to cut down the allowable deduction for charitable contributions or to change the meaning of the term "net income," we must presume that the plain meaning of Sections 21, 22 and 23 of the Revenue Act of 1928 has not been abrogated.

When Congress makes a change in an existing revenue act, it is the well established policy of the

House Ways and Means Committee and the Senate Finance Committee to explain the nature of the change in their reports. When Congress proposed the adoption of the capital gain provisions, the Senate Finance Committee expressly stated in its report covering the Revenue Bill of 1921 that the allowable deductions are substantially the same as under existing law. If Congress had any intention of impairing or destroying the 15% deduction for charitable contributions when a taxpayer elected to be taxed on his capital gain at 12½%, it would have used appropriate language in the act to effectuate such a purpose.

Congress not only used the term "net income", in Section 23 (n) of the Revenue Act of 1928 providing for the 15% limitation on the deduction for charitable contributions, but also employed the same term in Section 120, allowing an unlimited deduction for charitable contributions where the taxpayer in the taxable year and ten preceding taxable years made contributions in excess of 90 per cent of his net income, including taxes paid, and in Section 706 providing for a limited deduction for charitable contributions to a trust in the year 1923. If the term "net income", as used in Sections 120 and 706 were construed to mean net income, excluding capital gains, it would obviously do violence to the plain legislative purpose of the enactment of these sections.

In Report No. 398, 68th Cong., 1st Sess., Senate Finance Committee, covering the Revenue Act of 1924, it is stated on the subject of the unlimited de-

duction for charitable contributions (at p. 24) as follows:

> "Section 214 (a) (2) * * * The paragraph has been further amended to provide that the limitation upon the amount of deductions allowable under this paragraph to 15 per cent of the taxpayer's net income shall not be applied, if the taxpayer has for each of the 10 preceding years, as well as the year in question, contributed an amount equal to or exceeding 90 per cent of his income to the organizations and for the purposes specified in this paragraph. This provision is designed substantially to free from income taxation one who is habitually contributing to benevolent organizations amounts equalling virtualy his entire income."

Congress, instead of evincing an intent or purpose to impair or destroy the deduction for charitable contributions, has manifested a policy of liberality towards benevolently inclined taxpayers.

Congress in the use of the term "net income", in Sections 23 (n), 120 and 706 of the Revenue Act of 1928 obviously meant net income subject to tax, including capital gains.

C

THE TERM "NET INCOME," AS USED IN SECTION 23 (n) MEANS THE NET INCOME AS DEFINED BY SECTIONS 21, 22 AND 23 AND INCLUDES A CAPITAL NET GAIN.

The "net income", which is subject to tax under the Revenue Act is a statutory concept. Section 21

of the Revenue Act of 1928 defines "net income", as the gross income computed under Section 22, less the deductions allowed by Section 23. Section 22 (a) expressly provides that "gross income", includes the gain derived from sales or dealings in property, whether real or personal, and therefore no taxpayer can hope to escape taxation of a capital gain by contending that it falls without the purview of Section 22 (a). Section 22 (e) expressly covers the computation of the taxable gain in the case of a sale or other disposition of property.

The computation of net income is made under Sections 21, 22 and 23 of the Revenue Act of 1928, and not under the capital gain provisions.

The Treasury Regulations from 1921 to 1932 have recognized that income derived from the sale of capital assets is part of the statutory net income. In Treasury Regulations 74 under the Revenue Act of 1928, it is stated (at p. 8):

> "Art. 41. Meaning of net income. The tax imposed by the Act is upon the income. In the computation of the tax various classes of income must be considered:
>
> "(a) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes in the forms of income specifically described as gains and profits, *including gains derived from the sale or other disposition of capital assets.* * * * " (Italics supplied.)

Article 21 of Regulations 62 under the 1921 Act, Article 21 of Regulations 65 under the 1924 Act, and Article 21 of Regulations 69 under the 1926 Act contain identical language on this subject.

A capital gain also falls within the general and accepted definition of income for taxation purposes which the Supreme Court held to be "the gain derived from capital, from labor, or from both combined."

> *Eisner* v. *Macomber*, 252 U. S. 189, 40 S. Ct. 189, 193, 64 L. Ed. 521, 9 A. L. R. 1570;
>
> *Merchants' Loan & Trust Co., Tr* v. *Smietanka*, 225 U. S. 509, 517, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305.

See also *American Can Co.* v. *Bowers*, 35 F. (2d) 832, 834, certiorari denied, 281 U. S. 736, wherein it is stated:

> "Necessarily, net income, for tax purposes is a conception of the income tax statute, and the amount arrived at is ascertained by deducting from the gross amount of income received by the taxpayer from all sources the specified deductions allowed to it by statute."

D

IT WAS THE ADMINISTRATIVE PRACTICE OF THE COMMISSIONER FROM 1921 TO 1932 TO ALLOW AS A DEDUCTION CHARITABLE CONTRIBUTIONS UP TO 15 PER CENT OF A TAXPAYER'S TOTAL NET INCOME, INCLUDING CAPITAL NET GAIN.

As has been previously stated, all of the revenue acts from 1917 to 1934 on the question involved limited the

deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income before any allowance for contributions. The Government now maintains that the introduction of the capital gain provisions commencing with the Revenue Act of 1921 carried with it an exclusion of such gain from net income in computing the 15% deduction for charitable contributions, so that the administrative practice of allowing a deduction to the extent of 15% of a taxpayer's net income under the Revenue Acts of 1917 and 1918 is not decisive.

However, this administrative practice of the Commissioner of Internal Revenue to allow a deduction for contributions to the extent of 15% of a taxpayer's net income, including capital gains, continued throughout the Revenue Act of 1921, 1924, 1926 and 1928, all of which acts contained capital gain provisions in substantially the same language, down to January 27, 1932, when the Commissioner promulgated Mim. 3931, Internal Revenue Bulletin XI-7, p. 2, of February 15, 1932, Cumulative Bulletin XI-1, p. 33. This mimeograph was issued after the decision of the Board of Tax Appeals in *Hallie D. Elkins*, 24 B. T. A. 572, (decided November 3, 1931), which involved the determination of the deduction for charitable contributions where the taxpayer sustained a capital net loss, a problem unlike the present one, and it was therein provided that pending final court decision in the *Elkins* case, capital net gains are to be excluded in the audit of returns for 1929 and subsequent years in arriving at the net income subject to the 15% limitation in ascretaining the deduction for charitable contributions. The capital net loss provisions first appeared in the Revenue Act of 1924.

The Government, however, never prosecuted an appeal from the decision of the Board in the *Elkins* case, supra, and there is no case pending in court involving the amount allowable as a deduction for charitable contributions where the taxpayer sustained a capital net loss, as far as this counsel is informed.

In Prentice-Hall Federal Tax Service for 1932, page 14905, par. 14910, it is stated:

> "Fifteen per cent limitation for deductions account charitable contributions applies to total net income inclusive of gain from sale of capital assets. (Telegram to A. B. Trudgian, New York, signed E. W. Chatterton, Deputy Commissioner, dated February 6, 1923)."

This decision was promulgated under the Revenue Act of 1921, which contained capital gain provisions substantially the same as appear in the 1928 Act. This decision was consistently followed by the Bureau of Internal Revenue until the issuance of Mimeograph 3931 referred to above, all of which accounts for the absence of any prior final court decision on the subject involved.

In *Ralph W. Harbison*, 26 B. T. A. 896 (decided August 29, 1932), *Susan Dwight Bliss*, 27 B. T. A. 205 (decided December 2, 1932 and *Mary Colgate*, 27 B. T. A. 506 (decided December 30, 1932), the Commissioner of Internal Revenue had allowed in his notices of deficiencies in tax a deduction for charitable contributions based on 15% of the taxpayers' total net income, including capital gains. The taxpayers appealed to the Board on other issues, and the Commissioner

in his answer, after changing his position on the 15% deduction for contributions where part of the net income consists of a capital gain, claimed an increased deficiency on the theory that the 15% deduction was limited to 15% of net income, excluding capital gains. Under Section 272 (e) of the Revenue Act of 1928, if an appeal is filed by a taxpayer with the Board, the Commissioner in his answer may claim a deficiency in tax greater than that asserted in his deficiency notice.

In the issuance of the notices of deficiencies in tax in the *Harbison*, *Bliss* and *Colgate* cases, supra, the Commissioner adhered to his long-continued administrative practice of allowing a deduction for contributions to the extent of 15% of a taxpayer's total net income, including capital net gain.

The decisions in these cases which upheld the Commissioner were written by three of the sixteen members of the Board, and were subsequently repudiated by the decision in the *Straus* case, which was decided by the full Board in a unanimous opinion.

It was never contemplated by the Treasury Regulations that if a taxpayer enjoyed a capital net gain, his deduction for charitable contributions should be confined to 15% of his ordinary net income.

In Article 251 of Regulations 62 under the Revenue Act of 1921, it is provided in part as follows:

> "Art. 251. Charitable contributions.—Contributions or gifts within the taxable year are deductible to an aggregate amount not in excess of 15% of the taxpayer's net income, including such payments, * * *."

The same language was repeated in Article 251 of Regulations 65 under the 1924 Act, Article 251 of Regulations 69 under the 1926 Act, Article 261 of Regulations 74 under the 1928 Act, and Article 261 of Regulations 77 under the 1932 Act. There is no language in the regulations which purports to confine the 15 per cent limitation to ordinary net income where part of the net income consists of a capital net gain.

This is clearly a case where the long-continued and uniform departmental construction of the law should be held controlling. Both the law and the regulations provided that gains derived from the sale of capital assets formed a part of net income subject to tax. In the face of this administrative practice, Congress reenacted the capital gain provisions in essentially the same form by the Acts of 1924, 1926 and 1928. Congress has never at any time disapproved the administrative practice of permitting a deduction for charitable contributions to the extent of 15% of a taxpayer's total net income subject to tax, including capital net gains. The deduction for charitable contributions served as an inducement to taxpayers to donate to charity, and many philanthropically minded taxpayers contributed to charitable institutions subsequent to the enactment of the Revenue Act of 1921 large sums in excess of 15% of their ordinary net income. They have parted with their money in reliance of the law and the administrative practice thereunder. It was the purpose of Congress to free from taxation contributions up to 15% of a taxpayer's total net income. Congress was not interested in the characterization of the net income under the Act. The net income from investment property held more than two years and taxed at 12½% was denominated a capital net

gain, but it nevertheless formed a part of a taxpayer's taxable net income under the Act.

It is fair to assume that if the departmental interpretation which was a long-continued and consistent one did not properly reflect the meaning and intent of Congress, that body would have challenged and corrected such holding instead of continually reenacting the capital gain and charitable contribution sections in their existing language. Having refrained from making any change in the provisions affecting the deduction for charitable contributions, it must be presumed that Congress was content with the Commissioner's administrative interpretation. This principle of law has been consistently adhered to by the Supreme Court of the United States in a long line of cases:

U. S. v. *Dakota-Montana Oil Co.*, 288 U. S. 459;

McCaughn v. *Hershey Chocolate Co.*, 283 U. S. 488, 492;

Poe v. *Seaborn*, 282 U. S. 101, 117;

Universal Battery Co. v. *U. S.*, 281 U. S. 580;

Brewster v. *Gage*, 280 U. S. 327, 337;

National Lead Co. v. *U. S.*, 252 U. S. 140;

Latimer v. *U. S.*, 223 U. S. 501, 504;

U. S. v. *Baruch*, 223 U. S. 191, 199;

Komada & Co. v. *U. S.*, 215 *U. S.* 392, 396;

U. S. v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 339;

Copper Queen Mining Co. v. *Arizona Board*, 206 U. S. 474, 479;

U. S. v. *Falk and Bro.*, 204 U. S. 143, 152;

N. Y., N. H. & H. R. R. Co. v. *I. C. C.*, 200 U. S. 361, 401;

Robertson v *Downing*, 127 U. S. 613;

U. S. v. *Philbrick*, 120 U. S. 52, 58;

McDonald v. *Hovey*, 110 U. S. 619, 629.

The principle of law enunciated by these cases operates with equal force for the benefit of the taxpayer as well as the Commissioner of Internal Revenue.

The case of *Hallie D. Elkins*, 24 B. T. A. 572, involved the determination of the amount of the deduction for charitable contributions where the taxpayer sustained a capital net loss. In that case, the taxpayer had an ordinary net income of $113,151.98 in the year 1924, exclusive of charitable contributions, and a capital net loss of $127,259.41. The taxpayer made charitable contributions of $8,632.65. Under the Revenue Act of 1924, the ordinary net income was subjected to a tax of $23,766.77, and a credit against this tax was allowed under the Act to the extent of 12½% of the capital net loss. There was no election under the Act where the taxpayer came within the provisions of the capital net loss section. The application of its provisions was mandatory. While in that case, the loss was in excess of the income, nevertheless the taxpayer was required to pay a tax. The Commissioner refused to allow any deduction for charitable contributions, because the taxpayer's loss was in excess of her income.

Trussell, who delivered the opinion of the Board, said (at p. 276) :

> "* * * The reasonable and, in our opinion, the proper interpretation of the applicable sections of the 1924 Act is that when Section 208 (c) is applied, as it must be in this case, the 'ordinary net income' is the basis for determining the amount deductible on account of charitable contributions. * * * It is untenable to say that for the purpose of computing a tax liability this petitioner has a net income of $113,151.98 and that at the same time she has no net income for the purpose of computing the amount allowable as a deduction for contributions."

Apparently the Board adopted a liberal interpretation of the statute in order to avoid an absurd result and to carry out the manifest policy of Congress of aiding charity by allowing a limited deduction for contributions. The problem presented by the *Elkins* case, supra, is unlike the present one. The Government did not prosecute any appeal from the Board's decision in the *Elkins case*, or in any case involving a state of facts similar to those in the *Elkins* case, and it is therefore unnecessary for the Court to pass upon the validity of the decision of the Board in the *Elkins* case. Here, the taxpayer was required to pay a tax on income derived from a capital gain. It would also be untenable to say in this case that the taxpayer must pay a tax on this capital gain, but that it must be excluded from net income in computing the amount allowable as a deduction for contributions.

There is a well established rule that a statute is not to be given an interpretation which will lead to absurd

consequences inconsistent with the legislative purpose.

U. S. v. *Katz*, 271 U. S. 354, 357;

Lau Ow Bew v. *U. S.*, 144 U. S. 47, 59;

Church of Holy Trinity v. *U. S.*, 143 U. S. 457;

U. S. v. *Kirby*, 74 U. S. 482;

Stonega Coke & Coal Co. v. *Commissioner of Internal Revenue*, 57 F. (2nd) 1030, 1031;

In the *Katz* case, supra, Mr. Justice Stone, who delivered the opinion of the Court, made the following observation:

> "All laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose. See Hawaii v. Mankichi, 190 U. S. 197, 212, 47 L. ed. 1016, 1020, 23 Sup. Ct. Rep. 787, 12 Am. Crim. Rep. 465, and cases there cited. In ascertaining that purpose, we may examine the title of the Act (United States v. Fisher, 2 Cranch, 358, 386, 2 L. ed. 304, 313; United States v. Palmer, 3 Wheat. 610, 631, 4 L. ed. 471, 477; Church of the Holy Trinity v. United States, 143 U. S. 457, 462, 36 L. ed. 226, 229, 12 Sup. Ct. Rep. 516), the source in previous legislation of the particular provision in question (United States v. Saunders, 22 Wall. 492, 22 L. ed. 736; Viterbo v. Friedlander, 120 U. S. 707, 30 L. ed. 776, 7 Sup. Ct. Rep. 962; United States v. Morrow, 266 U. S. 531, 535, 69 L. ed. 425, 427, 45 Sup. Ct. Rep. 173), and the legislative scheme or plan by which the general purpose of the act is to be carried out. (See Platt v. Union P. R. Co., 99 U. S. 48, 63, 64, 65, 25 L. ed.

424, 429; Bernier v. Bernier, 147 U. S. 242, 246, 37 L. ed. 152, 154, 13 Sup. Ct. Rep. 244).

In the decision of the instant case, it is not necessary to pass upon the validity of the decision of the Board in the *Elkins* case, supra. While the Commissioner previously acquiesced in the decision in the *Elkins* case, it is his present administrative practice to include the amount of a capital net loss in the computation of net income for the purpose of Section 23 (n), and to disallow any deduction for charitable contributions where the capital net loss is in excess of ordinary net income even though a taxpayer may be required to pay a tax.

In the case of a capital net gain, the amount thereof constitutes the net income derived from the sale of investment property held more than two years and forms a part of net income subject to tax.

In the case of a capital net loss, the amount thereof to the extent of 12½% is allowed as a credit against the normal and surtaxes due on the ordinary net income. The ordinary net income constitutes the net income subject to tax, and against the tax due thereon, there is allowable a credit of 12½% of the capital net loss.

It may be the view of this Court that the net income subject to tax as computed before the deduction for contributions is the basis for determining the 15% limitation on the deduction for charitable contributions and that the statute is not to be given a literal application so that the beneficient purpose of Congress may be effectually accomplished.

The Board in the *Straus* case avoided any expression of opinion as to the soundness of its decision in the *Elkins* case, and merely stated:

> "The cases involving capital net losses may or may not be distinguishable from those involving capital net gains. We express no opinion on that subject, but confine ourselves strictly to the question before us."

On the subject of the deduction for charitable contributions, it is interesting to observe the comments of Robert H. Montgomery in Federal Tax Handbook (1932) at pages 475-476 thereof:

> "Inclusion or Exclusion of Capital Net Gain or Loss for the Purpose of Applying the 15 Per Cent Limitation.—The 15 per cent limitation on the deduction of contributions is based on the statutory 'net income.' 'Net income' as defined by section 21 of the Act means the gross income computed under Section 22, less the deductions allowed by Section 23.
>
> " 'Gross income' as computed under Section 22 includes capital net gain but the deductions listed under Section 23 do not include capital net loss.
>
> "The Treasury formerly permitted the inclusion of capital net gain to arrive at net income for the purpose of computing the limitation (C. B. III-1, 198, I. T. 2013; C. B. III-2, 152, I. T. 2104), and required the deduction from net income of capital net loss for the same purpose. In *Elkins* v. *Com'r* (24 B. T. A. 572) (NA) and *Livingood, Ex'r* v. *Com'r* (25 B. T. A. 585), however, the Board held that capital net losses should not be taken into consideration in computing net income

for purposes of the limitation, inasmuch as capital net losses are not among the list of statutory deductions from gross income in arriving at statutory net income. In view of this decision reversing the established policy of the Treasury, the Treasury issued a ruling (C. B. X. I-7-5386; Mim. 3931) denying the right of taxpayers to include capital net gain in the computation of net income for the purpose of applying the limitation, pending the outcome of its appeal in the *Elkins* case.

"In a decision just promulgated (*Harbison* v. *Com'r*, 26 B. T. A.—, August 29, 1932) the Board of Tax Appeals has taken a similar position to that of the Treasury in Mim. 3931, supra, and has held that in determining the 15 per cent limitation for deduction of contributions the amount of capital net gain should be excluded from ordinary net income.

"The Board's reasoning to justify its position in this case is very weak, holding in effect that when the taxpayer elects to report capital net gain his tax liability is determined in two parts, the capital net gains part not being included in 'net income.' This appears to be an incorrect interpretation of 'net income') (Section 21) and the provisions of Section 23 (n) relating to deductions for contributions, etc."

Since the above was written the three members of the Board who rendered the decisions in the *Harbison*, *Bliss* and *Galeote* cases, supra. reversed themselves by concurring in the unanimous opinion in the *Straus* case, and by following rule announced therein in later cases.

E

THE CAPITAL GAIN PROVISIONS DO NOT SERVE TO IMPAIR OR DESTROY THE DEDUCTION FOR CHARITABLE CONTRIBUTIONS.

The objective of the capital gain provisions was to expedite sales of investment property held by taxpayers for more than two years which had been retarded by the high surtaxes, as was well stated by Mr. Justice Stone in *Burnet* v. *Harmel*, supra, and by Mr. Justice Butler in *Helvering* v. *New York Trust Co.*, supra. In analyzing the capital gain provisions, the intention of Congress and the object sought to be accomplished are important factors.

Congress did not use any language in the capital gain provisions according a flat rate of 12½ per cent on the gain derived from the sale of capital assets to indicate any intent to invade Section 23 (n) governing the deduction for charitable contributions with the effect that the deduction is impaired or wholly destroyed. Congress did not by the adoption of the capital gain provisions of Section 101 intend to ingraft into Section 23 (n) a further limitation limiting the deduction to 15 per cent of a taxpayer's ordinary net income if he had a capital net gain.

Congress in furtherance of the policy to encourage sales of investment property by according an optional rate of 12½ per cent did not intend to subvert another policy to encourage charitable contributions. The two policies are unrelated and both of them can be effectually accomplished by placing upon the statu-

tory provisions a reasonable construction which will serve the plain Congressional purpose. If it had been the purpose of Congress to cut down on the deduction for charitable contributions where a taxpayer had a capital net gain, it would not have hidden its intent in the capital gain provisions, but would have used appropriate language in Section 23 (n) which fixes the limitation on the deduction.

Section 101 does not purport to provide the standards by which net income is computed. "Net income" has been defined by Sections 21, 22 and 23, and is computed under those sections. Section 101 provides an optional rate of tax on a capital net gain, and defines that term. The evident purpose of Congress was to carve out of a taxpayer's total net income his net income from the sale of investment property held more than two years and give him an election to be taxed thereon at 12½ per cent. Congress, instead of envincing an intent in Section 101 to impair or destroy any deduction allowed a taxpayer by Section 23, was careful in its draftsmanship to preserve the same.

Section 101 (c) (5) defines a "capital net gain" to mean the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

All of these terms are defined in Section 101. There is a substantial difference between the meaning of the terms "capital gain," and "capital net gain."

Section 101 (c) (1) defines a "capital gain," to mean taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

Section 101 (c) (8) defines "capital assets," to mean property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business.

Section 101 (c) (3) defines "capital deductions," to mean such deductions as are allowed by Section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

Section (101) (c) (2) defines a "capital loss," to mean a deductible loss resulting from the sale or exchange of capital assets.

Section 101 (c) (4) defines "ordinary deductions," to mean the deductions allowed by Section 23 other than capital losses and capital deductions.

The term "gross income," as used in Section 101 (c) (5) in association with the language "computed without including capital gains," undoubtedly means the "gross income," as defined by Section 22.

No part of the deductions allowed by Section 23 is lost in the process of singling out the amount of the

capital net gain for the purpose of according the same a flat tax of 12½ per cent at the taxpayer's election.

The application of the capital gain provisions may be illustrated by using the figures which are set forth in the opinion in the *Straus* case. It was stipulated in that case that the taxpayer had in the year 1929 a "capital gain," of $766,463.96 as defined by Section 101 (c) of the Revenue Act of 1928, but without any allowance of a deduction for charitable contributions. It was also stipulated that the taxpayer had not items of capital deductions or capital losses. It was also stipulated that the taxpayer had an "ordinary net income," of $43,079.90 as defined by Section 101 (c), but without any allowance of a deduction for contributions as provided by Section 23 (n). The taxpayer had a "gross income computed without including capital gains," of $159,831.87 and the amount of the ordinary deductions without any deduction for contributions was $116,751.97, making the difference of $43,079.90. The taxpayer donated to charitable institutions the sum of $144,695.04, and the Board allowed the sum of $121,431.58, being 15 per cent of the taxpayer's total net income of $809,543.86, consisting of ordinary net income of $43,079.90 and capital gain of $766,463.96, as computed before the deduction for contributioins.

Now, what is the amount of the taxpayer's capital net gain subject to the 12½% tax? Section 101 (c) (5) clearly states that it is the excess of the amount of capital gain over capital deductions and capital losses plus the amount, if any, by which the ordinary

deductions exceed the gross income computing without including capital gains. The amount of the capital gain is $766,463.96 and the taxpayer had no capital deductions or capital losses in the year 1929. However, the ordinary deductions to which the taxpayer was entitled in the year 1929 exceeded the gross income computed without including capital gains. Section 101 (c) (4) defines ordinary deductions to mean the deductions allowed by Section 23 other than capital losses and capital deductions. One of the deductions allowed by Section 23 is for charitable contributions limited only by 15% of the taxpayer's net income. Since the allowable amount for charitable contributions is the sum of $121,431.58, and the taxpayer only had a gross income, computed without including capital gains, of $159,831.87 and the amount of the ordinary deductions without any deductions for contributions was $116,751.97, there was clearly an excess of ordinary deductions over ordinary gross income which under Section 101 (c) (5) was permitted to invade the "capital gain," in arriving at the "capital net gain," subject to the 12½% tax. This is a subject which apparently the Board did not consider in its prior three decisions, but was given effect to in the decision of the *Straus* case.

In Report No. 179, 68th Cong., 1st Sess., Committee on Ways and Means, covering the Revenue Bill of 1924, it is stated at p. 19:

> "Section 208. * * * In the bill paragraph (4) is inserted, and the two succeeding paragraphs are changed in order to revise the definition of capital net gain so that the tax in cases where there is a deficit in ordinary income will be

> 12½% of an amount determined by subtracting from the capital net gain the amount of the deficit in ordinary net income. This provision is in the interest of the taxpayer."

The Board determined that the sum of $688,112.28 represented the amount of the "capital net gain," under Section 101 (c) (5) in the *Straus* case. This was arrived at by subtracting from the "capital gain," of $766,463.96 the amount of $78,351.68, representing the amount by which the "ordinary deductions," exceeded the "gross income computed without including capital gains." Such gross income amounted to $159,831.87 and the ordinary deductions without any deduction for contributions totaled $116,751.97. The Board allowed the sum of $121,431.58 as an "ordinary deduction," for charitable contributions. The ordinary deductions therefore totaled $238,183.55, and exceeded the ordinary gross income by the sum of $78,351.68. There were no items of capital deduction or capital losses in the *Straus* case.

The Revenue Act of 1921 while it taxed specially a capital net gain at 12½%, it failed to expressly provide for an invasion of capital gain where the ordinary deductions exceeded the ordinary gross income.

Congress by the adoption of the capital gain provisions did not expressly or impliedly intend to impair or destroy the deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income provided for in Section 23 (n). By a careful study of Section 101 (c), it is found that Congress was careful in preserving to a taxpayer his usual and ordinary deductions and commencing with the Rev-

enue Act of 1924, it was expressly provided that if there was an excess of ordinary deductions over ordinary gross income, such excess was to be subtracted from the amount of capital gain, in arriving at the amount of the capital net gain subject to the 12½% tax.

Section 101 makes no reference to any further limitation on the deduction for charitable contributions contained in Section 23 (n). Section 101 (a) authorizing a 12½% tax on capital net gains must necessarily be read in the light of Section 101 (c) to ascertain if Congress by the adoption of these provisions impliedly intended to cut down the 15% limitation contained in Section 23 (n).

Congress in defining a capital net gain in Section 101 (c) (5) expressly provided that if the ordinary deductions exceeded the gross income computed without including capital gains, the excess was to be dededucted from the amount of the capital gain in determining the capital net gain. We then pass to Section 101 (c) (4) to ascertain if the 15% deduction for contributions is one of the ordinary deductions, and find that "ordinary deductions," means the deductions allowed by Section 23 other than capital losses and capital deductions. Section 23 expressly provides that in computing net income there shall be allowed as a deduction for charitable contributions an amount not to exceed 15% of the taxpayer's net income. It may therefore be said that Congress expressly preserved to a taxpayer as an ordinary deduction his charitable contributions limited only by Section 23 (n). When Congress in Section 101 (c) (7) provided that 'ordi-

nary net income" means the net, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions, it certainly did not intend to exclude the ordinary deduction for charitable contributions not in excess of 15% of a taxpayer's net income. By ordinary rules of grammar, the second clause, "computed in accordance with the provisions of this title," merely explains and identifies what is meant by the expression "net income." "This title," means Title I. Net income computed in accordance with Title I is obviously net income as defined in Section 21 of Title I, i. e., gross income as defined in Section 22 less the deductions allowed by Section 23. In other words, Section 101 (c) (7), where it speaks of net income, means the net income which has been computed in accordance with Sections 21, 22 and 23, but "ordinary net income," means such net income after excluding all items of capital gain, capital loss and capital deductions, that is to say, after excluding capital net gain or capital net loss. The only other possible construction would be to pay no attention to the second comma, between "title" and "after," and attempt to arrive at an anomalous net income by first excluding items of capital gain, capital loss, and capital deductions. That, however, would not be net income and an analysis of the provision can leave no doubt that one must start with net income as computed in accordance with Sections 21, 22 and 23 and then exclude all items of capital gain, capital loss and capital deduction in arriving at ordinary net income.

Section 101 (c) (7) does not in any sense, directly or impliedly, invade Sections 23 (n), 120 or 706 deal-

ing with the deduction for charitable contributions. In order to accomplish effectually the object of Congress in computing a separate rate of tax on capital net gain, Section 101 (c) (7) necessarily had to exclude all items of capital gain, capital loss and capital deductions, but the exclusion of these items does not carry with it an exclusion of the ordinary deduction for charitable contributions. To do so, is to read into Section 101 (c) (7) language which does not appear therein. It would be just as sensible to exclude under Section 101 (c) (7) a deduction for interest at the rate of 6% per annum which a taxpayer may have paid to a bank for a loan to carry capital assets. The only limitation on the deduction for charitable contributions is contained in Section 23 (n) as applied to the instant case, and Congress showed no purpose in the capital gain provisions to impair or destroy this deduction.

As further evidence of the fact that Congress recognized that capital gains were included in gross income as that term is used in Section 22 in computing the net income on which the deduction for contributions is based, reference may again be made to Section 101 (c) (5) which in part provided that in arriving at the capital net gain, "the amount, if any, by which the ordinary deductions exceed the gross income *computed without including capital gains*," was to be substracted from the amount of the capital gain. Why should Congress specify "gross income" *computed without including capital gains*, unless where the term is used without limitation, as in Section 22, "gross income" includes capital gains?

A further clear indication that all items of gross income and deductions that may be found in the statute

are included in Sections 22 and 23, is derived from the fact that Sections 101 (c) (3) and 101 (c) (4) show clearly that the capital deductions and ordinary deductions are, together, those deductions found in Section 23.

Summarizing the question of interpretation, it will be seen that Congress has given a statutory definition to the term "net income" as including all items of gross income less all items of deductions, and necessarily, therefore, the term must include both ordinary net income and capital gain, as is shown conclusively to be true by reference to Section 101 (c) (7) and Sections 168 and 186.

Having defined the terms, the operating provisions of Section 101 present no difficulty. Paragraph 101 (a) provides that in the case of any taxpayer, other than a corporation, who derives a capital net gain, there shall at the election of the taxpayer be paid in lieu of other taxes a tax determined by first computing a partial tax upon the basis of the ordinary net income at the rates and in the manner as if Section 101 had not been enacted, and by regarding the total tax as such amount plus 12½% of the capital net gain. There is no suggestion here of recomputing net income; there is simply a special provision for determining a tax upon net income which includes or comprises capital net gain. There is no more necessity for recomputing net income than there would be where net income includes dividends, or interest on Government bonds. Certainly in view of the fact that Congress in Section 101 (a) provided that a partial tax shall be first computed at the rates and in the manner as if this Section

had not been enacted, there was no intention of disturbing the ordinary deduction for charitable contributions.

It has been suggested that Congress meant to penalize a taxpayer for taking advantage of the tax on capital net gains. No such intention exists in the statute, and the provision for the special taxation of capital net gains was designed at least as much for the benefit of the Government as of the taxpayers, it being intended thereby to stimulate the sales of investment property held by taxpayers more than two years which were retarded by the high surtaxes.

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IF THE STATUTE IS AT ALL AMBIGUOUS AND A DOUBT EXISTS, SUCH DOUBT IS TO BE RESOLVED AGAINST THE GOVERNMENT.

The Commissioner apparently was not in doubt from 1921 to 1932 that the Act permitted a deduction for charitable contributions to an amount not exceeding 15% of the taxpayer's net income, including capital gains, and it was not until the year 1932 that a doubt existed in his mind as to the propriety of his action. If it can be said that the Act is not clear and is ambibuous on the subject of the deduction for charitable contributions, and a doubt as to its meaning exists, such doubt must be construed most strongly against the Government.

Gould v. *Gould*, 245 U. S. 151;

U. S. v. *Updike*, 281 U. S. 489;

Old Colony R. R. Co. v. *Commissioner of Internal Revenue*, 284 U. S. 552.

Further, the Courts apparently look with favor upon the provisions in the Revenue Acts with respect to charitable contributions and charitable exemptions, because they have given these provisions a liberal construction in order to effectuate the beneficient purpose of Congress.

Lederer v. *Stockton*, 260 U. S. 3;

Benziger v. *U. S.*, 193 U. S. 38, 55;

Andrus et al v. *Burnet*, Commissioner of Internal Revenue, 60 App. D. C. 182, 50 F. (2d) 332.

VI.

CONCLUSION

It is respectfully submitted that the term "net income," as used in Section 23 (n) means total net income subject to tax, as computed before the deduction for contributions, and includes a capital net gain. This is in accordance with the law and the uniform departmental practice from 1921, when the capital gain provisions were originally enacted, to 1932, when the Commissioner reversed his position. Since Congress reenacted the provision governing the deduction for contributions and the section dealing with capital gains in essentially the same language by the Acts of 1924, 1926 and 1928 in the face of this practice, Congress impliedly approved and adopted the administrative construction and this should prevail until changed by legislative action.

Congress by the adoption of the capital gain provisions sought to accomplish the single purpose of stimulating the sale of investment property which was retarded by the high surtaxes, and in effectuating this policy by Section 101, it evinced no purpose to subvert another policy namely that of encouraging contributions to charitable institutions.

A "capital net gain," as computed before the deduction for contributions is simply the net income derived from the sale of investment property held by a taxpayer for more than two years, and forms a part of "net income," as used in Section 23 (n). Such net income was characterized or denominated by Congress as "capital net gain," but it nevertheless constitutes income under the Act as that term is used in Sections 21, 22 and 23 (n).

It is submitted that the Act should be construed in such a manner as will effectually accomplish the beneficient purpose of Congress.

Respectfully submitted,

FREDERICK SCHWERTNER,
Counsel for Aaron Straus,
1000 National Press Building,
Washington, D. C.

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